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THE BRAZILIAN ECONOMY, 1945-1964¹

MARCELO DE PAIVA ABREU²

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² Professor of Economics, Pontifical Catholic University of Rio de Janeiro. The author wishes to thank Professor Bethell, the Department of Economics at PUC-Rio, the Centre for Brazilian Studies and St Antony's College, Oxford, for support which made possible to write this paper.

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The great depression followed by the Second War placed the Brazilian economy continuously under severe constraints. Industrial capacity and the infrastructure were under strain as difficulties were faced in relation to the access to resources to finance the maintenance of existing capacity and capital goods imports. This was due at first to balance of payments restrictions, then, during the war, to supply and transportation constraints. There was a dearth of capital goods after many lean years. There was also a clear expectation that United States financial support would be forthcoming as Brazil had provided to the US air bases in Brazil which had been a vital link to supply Africa and Brazilian troops had seen action in Italy.

The deposition of Vargas had led to the victory of General Dutra, a mainstream conservative candidate, without great political divergences with Vargas whom he had served as a rather pro-German Minister of War. In the economic field the lack of continuity was more marked as a group of liberally inclined civil servants occupied key positions in the Federal government. The emphasis of the new administration unwritten economic programme was placed on the need to invest in the infrastructure with the help of the United States and to control inflation, which had accelerated significantly since 1942. The most influential explanation for the acceleration of inflation was advanced by Gudin, the doyen of the critics of Vargas' policies. The public finance imbalance and the constraints on imports were singled out as important factors to explain the high rates of inflation. But Gudin also believed, and this "structural" explanation was certainly overemphasised at the time, that an important source of inflationary pressure was the imbalance between investments in the expansion of productive capacity of capital goods and those directed to the production of wage goods. This criticism of Vargas' industrial policies, and especially of the Volta Redonda project, was quickly endorsed by the government but does not seem to fit well with the data available on industrial structural trends. While the composition of investment may have had a marginal impact on the inflation rate its acceleration seems to be closely related to the government inability to mop up demand through a combination of rationing and the sale of government bonds. With the new government the embryo of a central bank was created in the form of a *Superintendência da Moeda e do Crédito*-SUMOC [Superintendence of Money and Credit] linked to the Bank of Brazil.

1. The quest for re-equipment: 1946-1955

The emphasis on stabilisation led to the government falling on the trap of overvaluation. The exchange rate, which should have been devalued from an average of around Cr\$18.50/US\$ dollar to some Cr\$30/US\$ if the objective was to maintain the 1939 real exchange rate level, was maintained at roughly the same level in nominal terms when legal parity was declared to the International Monetary Fund. There are indications that this decision reflected an unwarranted optimism amongst liberal economists, and made explicit by Eugênio Gudin, about favourable structural changes which had affected the Brazilian balance of payments. So during about one year and a half a highly overvalued rate was adopted and the Brazilian exchange regime was liberalised with the removal of controls.

Imports increased 84% in 1946 and then again more than 72% in 1947 to reach US\$1,012 million. Import prices increased more than 32% in the period. Although the level of foreign exchange and gold reserves had increased to reach US\$ 730 million by the end of 1946 about 37 % of the total reserves were inconvertible, of which US\$ 240 million in sterling. Brazil's trade with the dollar area was heavily in deficit so that the small dollar reserves were rapidly eroded. In 1947 the share of US goods in total imports reached 61.3%, its peak level in the 1940's. By mid-1947 dollar reserves had disappeared, but gold reserves were still substantial, so that the government faced the choice of converting part of the gold reserves, devaluing the cruzeiro or maintaining an overvalued rate with the introduction of import and foreign exchange controls. With an eye in the stabilisation targets this latter course was adopted and from mid-1947 Brazil's foreign exchange regime was similar to the former regimes of 1931-1933 and 1937-1939 with the same political economy implications. It is frequently overlooked that it was part of government policy to maintain untouched the level of gold reserves at US\$ 342 million, equivalent to four months of imports at the 1947 level. However reluctantly Brazil had finally entered the age of dollar shortage.

It is part of ill-informed nearly unanimous historical judgement that the Dutra administration irresponsibly squandered Brazil's foreign reserves. Curiously enough these claims are rarely accompanied by any condemnation of foreign exchange overvaluation and no mention is made of the substantial size of gold reserves after 1947. A closer look

at the figures also points out to the fact that there was not such a drastic change in the structure of imports in 1946 if compared to the past, especially if pent-up demand is duly taken into account: the share of imports of consumer goods in total imports rose from 16.9% in 1938 to 21.7% in 1946. However, to Brazilians used to extreme scarcity of foreign exchange since the early 1930's the much higher level of imports after 1945 and the availability of foreign consumer goods seemed slightly indecent. It is indeed difficult to overestimate the strength of the anti-import sentiment fostered by foreign exchange scarcity years after 1930. It is thus full of irony that the re-adoption of import substitution policies was a direct result of the crucial position of stabilisation in the priorities of 'liberal' policy-makers in the immediate post-war period. Import controls stimulated the import substitution of non-essential products, since the main rationing criterion was to favour essential imports so that imports of luxury goods tended to be relatively more affected than imports of capital goods or inputs. The share of consumer goods imports was reduced and that corresponding to capital goods increased. After the introduction of import controls there was a modest reduction of total imports not exceeding 10% until 1950. More importantly, there was a sharp substitution of imports originating in the dollar area by imports from non-dollar areas so that the deficit in the balance of payments with the dollar area was reversed. The fall of almost 12% in the price of imports also helped the government to regain control of the external accounts.

There is no study on the extent to which access to cheap imports enhanced the profits of importers of domestic manufacturers or were passed through to consumers. The relative prices of agricultural (food prices) and industrial goods rose increased rapidly by more than 40% between 1945 and 1948 and then hovered around the same level until the early 1960's. It is likely that more market power in certain branches of industry ended up by being reflected in the rise of relative prices of such goods in relation to those produced in more competitive sectors which were forced to transfer lower input costs to consumers .

Since the nominal level of the exchange rate remained constant from 1939 to 1952 inflation tended to erode the profit margins of exporters when export prices did not rise sharply as was the case of coffee. The long cycle which affected coffee prices was in the upswing after 1947 as world demand recovered and supply was constrained. Average coffee prices (Santos 4) increased from 22.6 US cents in 1948 to 27.4 in 1949 and 49.5

cents in 1950. It then remained between 49.5 and 53.8 cents in 1951-1953, before reaching 78.8 cents in 1954. The share of coffee exports in total exports which had reached a level under or around a third in 1940-1945 rose rapidly to reach more than 70% in 1952-1953. What had been considered export diversification had been indeed mostly a change in the relative prices between coffee and other Brazilian exports. Once coffee prices recovered, dependence on coffee exports was again evident. Since the United States was the main coffee market for Brazil the US market absorbed a growing share of Brazilian total exports: in 1950 this reached 54.3%, only lower than that of 1941, when almost all other leading traditional markets were closed to Brazilian exports.

Brazilian foreign exchange policy based on overvaluation contributed to strengthen coffee prices at least in the short term. Exports of products included in official procurement programmes during the war such as quartz, castor beans, diamonds, carnauba wax and processed beef collapsed after 1945. The same happened to exports which had benefited from the interruption of exports by traditional suppliers, such as cotton textiles and rubber products. In contrast with the decline in such non-traditional exports which was due to sudden changes in world demand, commodity exports other than coffee suffered with overvaluation. Such exports, of which cotton is the best example towards the end of the 1940's, became 'gravosas', that is production costs exceeded possible revenue levels given world commodity prices and the fixed exchange rate. The government had to resort to earmarked 'operations' ['operações vinculadas'] to ease pressure from producers, especially those of cotton. Through these expedients the government would serve as a broker between those exporters seeking better terms for their exports and importers who were prepared to pay more per unit of foreign currency to import goods which were not considered to be essential by the import control authorities. While the macroeconomic relevance of the scale of corruption in the allocation of foreign exchange cover tends to be exaggerated by some analysts it is obvious that government rationing through import controls and brokering in earmarked 'operations' created opportunities for corrupt practices in government.

Criticisms of the unfavourable effects of the overvalued exchange rate on exports need to be put into perspective since in many European markets for some time after the war export sales did not necessarily contribute to increase the capacity to import as

currencies were inconvertible and exports were in many cases constrained by stiff export controls in most European markets.

Perhaps the best example of such asymmetries is the accumulation of sterling balances in Britain. From the end of the war in Europe to the beginning of 1947 Brazil continued to supply Britain under the terms of the Anglo-Brazilian payments agreement of 1940 which made sterling accumulated in London unconvertible. So sterling balances increased from £40 million in V-E day to about £65 million by mid-1947. Neves da Fontoura, the Foreign Minister, made a visit to Britain in 1946 to seek British permission to use and misleadingly reported that the British were likely to agree that the balances would be used to buy ships and other capital goods for which there was pent-up demand in Brazil. It was a corollary of the agreement between Britain and the United States on British post-war finance that Britain refused to pay these debts out of current scarce export capacity. In spite of much British pressure Brazil refused to scale down its balances. As a preliminary to the failed British return to convertibility in mid-1947 the sterling balance holders were told that pre-convertibility balances would be frozen and only thawed in exchange for a comprehensive programme of sale of British assets involving mainly the railways. This took a long time and in fact there was some release of blocked sterling as an inducement for certain railway purchases of whose the most important were those of the very efficient San Paolo Railway and the rather inefficient Leopoldina. The remaining balances were used in a sudden redemption of Brazilian foreign debt in 1950 during a scare about a possible unilateral scale down of balances by Britain. While British direct investment was reduced by at least US\$ 165 million between 1938 and 1950 there was a rapid expansion of US investment which increased from US\$ 323 million in 1946 to US\$ 644 million in 1950 of which US\$ 284 million in manufacturing industry, US\$ 112 million in oil distribution, US\$ 138 million in utilities and US\$ 110 million in other investments. While investments in utilities were practically stagnant, other investments had increased more than 2.5 fold in these four years. Comparison with balance of payments data suggest that more than US\$ 200 million of the increase in 1946-1950 corresponded to new capital and the rest to reinvestment. Data on foreign investment other than British or from the US for the 1940's are notoriously defective and the semi-official estimates for direct investment in consequence somewhat inflated: it is hard to believe that in 1945 these investments made up half the capital stock of foreign capital.

The overvalued exchange rate resulted in a disincentive to new direct foreign investment implied as purchases of domestic goods and services would be relatively more expensive. There was also an inducement to maximise profit remittances. But the handicaps seem to have been compensated by potentially significant rent-seeking extraction in relation to both access to rationed imports of capital goods and inputs and exertion of market power in a market where protection against imports was made absolute by the prohibitions enacted by exchange control authorities.

Inflationary pressures were enhanced in 1946 by the significant impact of a pay rise to civil servants agreed by Gastão Vidigal, Dutra's first finance minister. This added more fuel to the impact of a significant rise in import prices so that inflation measured by the cost of living in 1946 remained above 16%, at the same level of 1945. With Correa e Castro as a new finance minister in late 1946, stabilisation returned to the top of the priority list and public expenditure was tightly controlled so that for the first time since the Old Republic there was a small fiscal surplus at the Federal level in 1947. In contrast, the deficit at the state level, especially in São Paulo and the Federal District, was very substantial, corresponding to 10-15% of their expenditures. This proved to be impossible to control, in spite of some progress in 1948, and did not fall below 4.5% of total expenditure. Banking credit which had been reduced by 10% in 1946 remained roughly constant in 1947-1949. Inflation measured by the wholesale prices started to decrease in 1947 but the consumer price yearly rate (Rio de Janeiro) peaked at 21.9% in 1947, as there was a sharp fall in agricultural output, before falling to 3-4% yearly in 1948-1949.

Following the political cycle which would doom many future stabilisation efforts, the emphasis of government policy on stabilisation lost all appeal as the elections of October 1950 became closer. By mid-1949 Correa e Castro was substituted by Guilherme da Silveira, a textile industrialist who favoured easy credit and fiscal policies. Increased public expenditure both by the Federal government and by the states in 1949-1950 reflected such a shift in policy. By 1950, the Federal deficit had reached almost 20% of the expenditures and was about twice the size of the aggregate deficit at state level. Lobbies in favour of looser policies were extremely powerful, including those seeking credit from the Bank of Brazil to profit from the industrial boom and populist politicians seeking to build up their political fiefs in the rapidly expanding urban areas. In 1950, real

credit increased in real terms by more than 20% only then exceeding its 1945 level. Thus in 1945-1950 real credit per unit of GDP was reduced by 25% in spite of the reversal of policy in the last eighteen months of Dutra's government. Difficulties were compounded by the bad crop of 1950, so that inflation measured by consumer prices in Rio de Janeiro started to accelerate again in 1950 reaching more than 9%.

Perhaps the most important failure of the Dutra administration was its inability to engage in a significant effort to overhaul the ailing existing infrastructure and expand capacity. Many Brazilian ships had been sunk during the war. Foreign exchange scarcity and supply constraints as well as low profits by utilities in 1930's and early 1940's not only made new investment impossible but also explained the deterioration of existing capacity in railways, electricity, telephones and railroads, owned either by the government or foreign concerns. Brazil had hoped that good behaviour during the war was going to be repaid with economic aid. But in 1946 it had already become clear that Brazil could no count on any special help from the United States. It was explicit US policy that the inflow of capital into Brazil should basically depend on Brazil's capacity to attract private direct investment rather than on any direct involvement by the US government. Limited finance was extended through some Export and Import Bank loans mainly to state enterprises to buy ships and also railway and electric equipment. The International Bank for Reconstruction extended a substantial loan to the Canadian-owned Brazilian Traction group which supplied electricity to Rio de Janeiro and São Paulo. Approved loans to Brazil added up to 11% of total International Bank loans in 1947-1950. But there was no Brazilian version of a Marshall Plan as expected by the government.

Efforts by the Brazilian government to plan the modernisation of infrastructure were embodied in the SALTE plan, whose name derived from the initials of the sectoral targets considered to be most important: health, food, transportation and energy. Salte also means an imperative 'jump' in Portuguese. It is not unreasonable to think that the first two 'sectors' were included due to a mixture of political convenience, as the social aspect had to be addressed, with the need for particular letters to give to the plan what was considered to be an attractive name which could mobilise political support for the government's programme of infrastructure construction. There were no comparable policies proposed for health and food supply. But the government's efforts were to be of

no avail, a crucial weakness of the Dutra government, to some extent shared by its successors, being its inability to assure political support in Congress. The SALTE plan was only approved by Congress in the last year of Dutra's term of office only to be abandoned by the new administration in 1951.

Progress in the improvement of social indicators in the 1940's was modest. In 1950 the infant mortality rate was still 144.7 per thousand live births (199 in Rio Grande do Norte and 99 in Rio Grande do Sul. Reduction of the shortcomings of infant mortality rates in relation to benchmark values of 10 deaths per thousand live births was of only around 10% in the decade. The literacy rate in 1950 was only 48.4% (44.2% for women) and improvement of literacy rates in relation to the benchmark of 100% progressed also at the low rate of 10% for the whole decade.

Political obstacles also made it impossible to approve new tax legislation proposed by the government, so that adjustment had to rely relatively more on expenditure control than would have been the case if the tax reform had been approved. Federal revenue depended essentially on the consumption and income taxes as import duties continued to lose importance due to the impact of inflation on the specific tariff. By 1950 the share of the consumption tax in total revenue was 34.4%, but the share of income tax was rapidly approaching it, to reach 30%.

The direct US government co-operation to solve the problems raised by the finance of economic development projects in Brazil was restricted to the efforts, in 1948, of a *Comissão Técnica Mista Brasil-Estados Unidos* [Joint Brazil-United States Technical Commission], generally known as the Abbink 1948 mission. Its report was marked by a deep pessimism about the prospects of Brazilian export prices which proved to be entirely misplaced at least in the mid-term. The emphasis was on the need to attract foreign capital and to assure that domestic savings were directed away from overinvestment in real estate. A few days before the Abbink report was presented Brazilian hopes had been raised by the reorientation in US policy entailed by point IV of the speech of President Truman in his inauguration which emphasised the importance of making US technical knowledge available to developing economies. There was finally hope of US government involvement in the long list of delayed infrastructural projects in Brazil. A *Comissão Mista Brasil-Estados Unidos para o Desenvolvimento Econômico*

[Joint Brazil-United States Economic Development Commission] was formed in the end of 1950 with the task of defining projects which could be submitted either to the Export and Import Bank or the International Bank for Reconstruction .

Although the previous government's institutional creative *furore* was brought under relative control, some new agencies were created and government involvement was increased in several sectors. In an indirect recognition of the difficulties related to the operation of foreign-owned electricity suppliers the Federal government decided to get involved in the production of hydro-electricity in the Northeast with the project of Paulo Afonso and the creation of *Companhia Hidroelétrica do São Francisco (CHESF)* [São Francisco Hydroelectric Company]. The other important decision concerning energy matters taken by the Dutra administration was related to oil refining. The debate on public ownership of the different segments of the oil industry had become increasingly partisan since oil had been found by the government in 1939. Pressure by the big international oil companies for a share of the Brazilian prospective oil production and refining had been mounting. The government allowed a couple of small projects owned by Brazilian firms to go ahead while no overall decision was reached on the role of the government and private capital in all segments of the oil industry.

The importance of regional imbalances was recognised by the creation of the first regional development agencies, the *Comissão do Vale do São Francisco* [São Francisco Valley Commission] and the *Superintendência do Plano de Valorização Econômica da Amazônia* [Superintendency of the Plan for the Economic Valorization of the Amazon Region]. A *Conselho Nacional de Pesquisas* [National Research Council] was created by Dutra in the closing month of his term of office. Its inspiration was centred more on the wish of the military to foster Brazil's knowledge of the possibilities opened by nuclear power than on a diagnosis that research would have to play a significantly more important role as a stimulus to economic development than in the past.

Vargas came out of his self-imposed isolation, in spite of being a senator, to win the 1950 elections. His alleged true electoral manifesto was to be a combination of policies first in the style of Campos Salles, and then of Rodrigues Alves. In the Brazilian political folklore, Campos Salles had given political backing to Joaquim Murinho in 1898-1902 to put the Republican finances in order after the turmoil in the 1890's and

Rodrigues Alves had undertaken a vast post-stabilisation programme of public works. In fact Alves also placed stabilization at the top of his list of priorities. But already in the selection of his economic team Vargas was unable to clearly choose stabilisation as the initial main objective.. The rather orthodox policies adopted by Horácio Lafer in the Ministry of Finance, which generated Federal budget surpluses 0.9% and 0.6% of the GDP in 1951 and 1952, have to be contrasted by the extremely expansionary credit policies adopted by Ricardo Jafet in the Bank of Brazil. The potential for friction between the Ministry of Finance and the Bank of Brazil would be a recurrent theme in the history of failed stabilisation attempts during the Third republic. Jafet had been the man in charge of the financing of Vargas' election and was not known for his endorsement of orthodox economic policies: Bank of Brazil credit to the private sector in nominal terms increased 66% in 1951 and 40% in 1952. Total banking credit in real terms increased by 13.7% and 8.7% in these years. Other developments put the government under pressure. The 1951 crop for domestic consumption was a not a success. Import US dollar prices increased almost 30% in 1951 and 8% more in 1952. The lack of Federal control on overspending by the state of São Paulo continued to be another major obstacle to the implementation of a coherent stabilisation programme. Between 1951 and 1952 the deficit by States and municipalities increased from 0.5% to 1.5% of GDP. The cost of living rate rose 17.3%. The high rate of increase in agricultural output in 1952 was mainly due to an important increase in cotton production but the crop for domestic consumption was still . Inflation measured by the cost of living rose in 1951 to 12.1% then to 17.3% in 1952. In 1953 pressures on the exchange rate which eventually led to an overhaul of the regime adopted since 1947 led, in spite of a recovery in food production, to an acceleration of inflation after a slight fall in 1953 to an yearly rate of 14.3% in 1953. In 1954-1956 inflation rates were around 21-23%.

The institutional arrangement between SUMOC, the Treasury, and the Bank of Brazil acting as a central bank was extremely peculiar and was repeatedly used to assure that there was no restriction to the growth of operations by the Bank of Brazil. SUMOC fixed the rediscount rate and the rates of compulsory deposit of commercial banks besides other functions related to the foreign exchange policy , the registration of foreign investment and the supervision of the banking system operations. It had a council which acted as the normative body in matters related to money, credit and foreign exchange. The Bank of Brazil operated the *Carteira de Redescontos-CARED* [Rediscount Office]

and the *Caixa de Mobilização Bancária-CAMOB* [Banking Mobilisation Office] so as to provide liquidity or to act as a lender of last resort. The Treasury had the legal authorisation to issue money and amortise it through a *Caixa de Amortização* [Amortisation Office] . But it could not put it in circulation which was an attribution of *CARED*.

When in need of cash the Bank of Brazil would rediscount commercial papers with *CARED* which would require a loan from the Treasury. When the commercial papers matured the Bank would return the cash to *CARED* which would be return it to the Treasury for incineration by the *Caixa de Amortização*. There had been since 1942 a theoretical limitation of short term indebtedness of *CARED* with the Treasury which could not exceed 25% of foreign reserves. But it was not binding as a long-term limitation as each time *CARED* exceeded the limit there a law was passed by Congress which determined that money in circulation should be ‘taken over’ by the Treasury with all debits of *CARED*, Bank of Brazil and the Treasury being cancelled out. A second carefully preserved loophole in the relation of the Bank of Brazil with the monetary authorities before 1964 was that being a commercial bank it also held the compulsory deposits of the other commercial banks with the monetary authorities. Since the Bank of Brazil made no distinction between his functions as a central bank and as a commercial bank part of the banking system reserves served as a basis for its own increased loans and advances.

Once again the stabilisation priority would be the main explanation for decisions which crucially affected the country’s balance of payments. From the first year of Vargas’ government in 1951 it was decided that an increased supply of imports was a required ingredient of a successful stabilisation programme. This resulted in a significant liberalisation of import controls, with a big increase in the import licenses issued. It was this change of policy, rather than the Korean boom, that was at the root of the foreign exchange crisis which marked the early 1950’s. With the nominal exchange rate still at the 1946 level, imports of around US\$ 1,700 million in 1951-1952 were more than 80% higher than in 1950, a substantial rise even if prices had increased 40%. The US share of the Brazilian market, which had been steadily declining, recovered to levels above 40% in the early 1950’s. Exports continued to increase in 1951: they were 30% higher than in 1950, reaching US\$ 1,771 million, but fell to barely more than US\$ 1.4 billion in 1952.

The traditional trade surplus almost disappeared in 1951 and was transformed into a trade deficit of almost US\$ 300 million in 1952. Such an import boom led to the accumulation of commercial arrears of US\$ 541 million at the end of 1952, with the Federal government very reluctant about using the gold reserves to pay for imports. The position was made even more serious due to the time lag between the issue of licenses and actual imports as it became clear that there had been an overshooting and too many licenses had been issued.

The Brazilian government sought financial accommodation in the United States to finance the thawing of these commercial arrears. The timing was unfortunate since the Republican victory in November 1952 had resulted in the weakening in the position of Eximbank in its fight with the World Bank for the Brazilian turf. In a speech in the end of 1951 Vargas had sharply criticised the practice of allowing the registration of unmerited profits by foreign corporations as foreign reinvestment which could be used as an additional basis to remit future profits. This declaration, is seen by some as a typical ruse by Vargas, trying to use his future return to good behaviour as a negotiating chip in the negotiations to extract a loan from the United States. It naturally raised strong protests abroad, including from the World Bank which had been trying since the end of the 1940's to avoid the erosion of its leverage in Brazil by restricting Eximbank activities to short or mid-term loans. The temporary rise in World Bank influence meant that Brazil, after adjustments in its foreign exchange regime was able to obtain a US\$ 300 million loan from Eximbank to be repaid in three years and with no grace period. With the Republican victory there was also a reversal of US policy on project finance in developing countries with the abandonment of Trumans's Point IV policy. It became clear that no additional US official finance would be available for projects selected by the *Comissão Mista Brasil-Estados Unidos*. The commercial arrears bailout in any case made it unlikely that the US would enter into additional financial commitments in Brazil. Total US loans for approved CMBEU projects amounted to US\$ 186 million only. The comprehensive overhaul of the infrastructure would have to be once again postponed. Brazil's total foreign debt which had been slowly reduced from US\$ 698 million by the end of 1945 to US\$ 559 million by the end of 1950 rose to US\$ 1,317 million by the end of 1954. But the debt-export ratio was still very low: it reached a minimum of 0.32 by the end of 1951 and increased to 0.85 by the end of 1954.

The deterioration in the external accounts led to a reform of the exchange regime in early 1953. Law 1807 also met partially the sharp criticisms to the old policy raised in the United States. The new foreign exchange regime was a next of kin of that of 1935-1937. Two exchange rates were pegged by the government: one more devalued was the free rate, the other was the official rate. Exporters of coffee, cotton and cocoa would be paid the official rate. Other exporters, at the discretion of the authorities, would sell compulsorily 15%, 30% or 50% of export proceeds at the official rate. Almost all financial transactions used the free rate as well all non-essential imports which amounted to about a third of total imports. Other purchases of foreign exchange were to be made at the official rate. The registration of unremitted profits as reinvestment was duly allowed.

Ricardo Jafet, who not only had undermined the stabilisation effort by adopting expansionary credit policies in the Bank of Brazil, but had also supported Vargas' unfortunate line on reinvestment of foreign capital, was sacked in the beginning of 1953 in the wake of scandals involving the 'operações vinculadas'. This came too late as stabilisation seemed doomed even before the impact of devaluation. Exports had not reacted to incentives provided in the new foreign exchange regime. In the first half of 1953 there were indications of lack of control with increased expenditure to cope with the effects of the dry season in the Northeast, to bail out state banks, to pay a civil service wage increase and to proceed with the public works programme. Vargas faced political defeat in the city of São Paulo elections and political agitation led to a massive strike in March in São Paulo. Lafer was substituted in mid-1953 by Oswaldo Aranha.

Aranha proceeded to change once again the foreign exchange regime. New rules allowed the sale in the free market of 50% of the proceeds of all exports with the exception of coffee. Minimum export prices were established and export proceeds beyond these thresholds could be entirely sold in the free market. But in spite of lip service concerning the control of the public deficit the government continued without instruments to raise additional resources.

Aranha's more permanent reform of the exchange regime tried to remove at the same time the constraints imposed by the balance of payments and by public finance. Instrução 70 of SUMOC of October 1953 introduced a system of 'ágios e bonificações', taking as reference the official rate of Cr\$ 18.32/\$US dollar declared to the International

Monetary Fund. Coffee exports would receive an extra payment, a 'bonificação' of Cr\$ 5.00/US\$ dollar; non-coffee exports would receive Cr\$ 10.00/\$US dollar. A new paper, 'promessa de venda de câmbio' [promise to sell foreign exchange], was created. These were to be auctioned and gave the right to the purchaser to buy foreign exchange. There were five different categories of auctions for imports, classified according to "essentiality". The authorities distributed discretionary foreign exchange as between different import category auction. About 80% of total allocated exchange was reserved to categories I to III and only 3% to category V of luxury goods. Certain special imports such as newsprint and wheat paid only the official rate. Oil imports as well government or state enterprise imports paid a surtax on the official rate. The result was that on average, for instance in 1953, the cost of imports per unit of foreign exchange varied between Cr\$ 18.82 and 78.90. Category V rate was 2.5 times the category I rate. The system acted as a substitute for tariffs as the Brazilian specific tariff schedule had been badly eroded by inflation. A 'free' rate applied to financial transactions.

The government could use the wedge between the average import rate and the average export rate as a fiscal instrument. But this was too little to cope with increased expenditure, especially transfers to the State of São Paulo. The deficit of states and municipalities fell only very slowly after 1953 to reach 0.9% in 1954. In spite of Jafet's replacement in the Bank of Brazil loans by the bank increased 36% in 1953. In 1953 the income tax had become the main Federal tax (32.6% of total revenue), marginally more important than the consumption tax (30.2%). By the end of 1953 all the fundamentals concerning fiscal, monetary and credit policies pointed to the failure of stabilisation. To this must be added the inflationary consequences of the rise in import prices caused by Instrução 70 which were in addition to those related to Law 1807. Inflation rates in 1954 were above 20% measured by the cost of living index.

Exports recovered very modestly in 1953 and 1954 in answer to changes in foreign exchange policy. They reached a peak of US\$ 1,771 million in 1951 and then fell to around US\$ 1.4-1.5 billion until 1957. There was a very substantial additional increase in coffee prices from a level of around 55-56 US\$ cents per pound in the first semester of 1953 to 62 cents in the end of the year rising to almost US\$ 1.00 in June 1954. This was due to a frost in Paraná and difficulties in competitive suppliers. A political campaign in the US led to a contraction in consumption while the Brazilian government established

minimum export prices. In the final months of Vargas' government export volumes were very low. In the middle of August the government finally decided to improve the conditions applying to the purchase of coffee export proceeds by allowing 20% of these proceeds to be sold at the much more devalued 'free' rate. Prices eased and there was some recovery in export volumes but they remained much below normal levels. The value of imports fell in 1953 to US\$ 1.1 billion, recovered in 1954 to US\$ 1.4 billion but this was the only year in the 1953-1964 period when it was not roughly between US\$ 1.1 and US\$ 1.3 billion. There was, however, a fall in import prices 1953-1954 of about 10% and a further fall of almost 15% until 1960. The decline in the US position as a major supplier to Brazil continued but it was still the major supplier in mid-1950's holding around a third of the market. The bad performance of exports is the main explanation for the permanent constraint on imports which would be one the most import obstacles faced by policy-makers in Brazil during the 1950's.

Difficulties faced by Aranha in the second quarter of 1954 were compounded by Vargas decision to double the minimum wage which added up to inflationary pressures even if it is considered that a substantial rise was required only to maintain the previous real wage peak in real terms. In 1952 the minimum wage had been increased 212% after a long period without adjustment since 1944 which led to a real fall of almost 55%. The increase was proposed by Goulart, the Labour minister, and adopted by the President in spite of strong opposition by Aranha. Typically, Vargas fired Goulart in sacrifice to his critics.

There was a new wave of creation of governmental, or government-controlled, institutions during Vargas' second government of which, retrospectively, the most important were *Banco Nacional do Desenvolvimento Econômico-BNDE* [National Economic Development Bank] and *Petróleo Brasileiro-Petrobrás* [Brazilian Oil]. *BNDE* was created in 1952 as a financial counterpart to the Comissão Mista Brasil-Estados Unidos. It was thus at the origin essentially a public-owned bank concerned with infrastructural projects. Later in the 1950's it became an important source of finance for projects which aimed at the import substitution of basic inputs. Petrobrás was vested with a far-reaching government monopoly which covered all aspects of oil production and processing. Only in distribution activities there was scope for the continued operations of the big foreign firms. Debate on the nature of government intervention in the oil industry

was marked by strong political mobilisation, particularly in the armed forces which were split by the issue. While victory of the '*o petróleo é nosso*' [oil is ours] campaign has become emblematic of a strategy based on state-controlled institution it is a matter for the record that, strangely enough, the comprehensive monopoly approved by Congress was a result of an initiative by the opposition to Vargas. Legislation initially proposed by the government provided for a less comprehensive span of monopoly activities. Taken jointly with the evidence on the establishment of *Companhia Siderúrgica Nacional* and *Companhia Vale do Rio Doce* the circumstances surrounding the foundation of *Petrobras* suggest a much less comprehensive effort by Vargas to build up public ownership in strategic sectors than is frequently taken for granted. The Federal government institutional building included the establishment of a *Fundo Federal de Eletrificação* [Federal Electrification Fund] and the creation of the embryo of a holding to control federal-owned electricity companies, *Centrais Elétricas Brasileiras-Eletrobrás* [Brazilian Electric Power Stations], which would be activated after 1961 when it would have control over the big Federal-owned electricity generation companies, of which only *CHESF* was operating in the early 1950's. The government also established a *Comissão Executiva do Plano do Carvão Nacional* [Executive Commission of the National Coal Plan] to cope with the problems raised by the absorption of low-quality coal produced in the South mainly through the construction of coal-burning thermoelectrical plants.

Vargas' suicide and its succession by the centre-right vice-president, Café Filho, created the conditions for a return of the 1945 'liberals' to economic policy-making. But the political conditions required for a serious attempt at stabilisation did not exist as Gudin, the new Finance Minister and leading conservative economist, would discover after only seven months in office. Interest rates were increased. And credit was squeezed by a steep increase in the compulsory deposits of banks in *SUMOC*. In 1954-1955 real banking credit remained 7-8% below its recent peak in 1952-1953. Budget expenditures were to be cut by 36%. Gudin's position was undermined by his difficulties to obtain political backing for expenditure cuts and also by Paulista objections to the low level of the export bonus ['*bonificação*'] paid to coffee growers which was only slightly higher than that under the exchange regime inherited from Aranha.

It was possible, however, to renegotiate a big loan with private banks in the United States to extend the maturing repayment period of credits for commercial arrears

which had been obtained under Vargas. This operation was guaranteed by US\$ 300 million of reserves in gold, reversing a policy which had been adopted since 1947 on the role of gold reserves. In relation to still another aspect of foreign economic policy, Gudin was unwittingly responsible for an economic policy instrument which would be of vital importance for the rest of the 1950's as an incentive to foreign capital inflows and the deepening of import substitution to reach more sophisticated branches of industry, in particular transportation equipment. This was SUMOC's instruction 113, which allowed imports of capital goods without exchange cover as direct foreign investment. Since foreign investment entered at the 'free' rate and exchange cover for imported capital goods had to be purchased at the category 3 auction there was a subsidy to foreign investment equivalent to the difference between the category 3 rate and the 'free' rate. Different views on the distributive impact of instruction 113 to a large extent reflect the comparison of such rates in different moments in time and consequently different relative levels of the 'free' and category 3 exchange rates.

A political deal between Jânio Quadros, the maverick governor of São Paulo, and Café Filho involving the substitution of the president of the Banco do Brasil led to Gudin's substitution by Whitaker, who returned to the Ministry of Finance after 25 years, once again representing the Paulista interests and especially those of coffee. Whitaker reversed Gudin's contractionary policies concerning credit and expenditure. His priority was to reform the multiple exchange rate system which was considered to hurt export interests and particularly those of coffee growers. Whitaker and Roberto Campos, superintendent of BNDE, following IMF advice, thought that Brazil should accept lower international coffee prices and increase market share and that the multiple exchange rate should be abandoned in favour of a single rate. There were pre-conditions to fulfil concerning consolidation of short-term foreign debt, a standby arrangement to avoid excessive fluctuation of the new rate and adjustment of the tariff schedule to cope with the removal of multiple import rates. A new tariff schedule would solve one of the problems raised by unification of the rates but IMF support would be essential to raise finance abroad. A report, written by Edward Bernstein, an IMF official, considered several alternatives for the new exchange regime. The Brazilian final draft proposed a regime based on a single floating exchange rate. There would be a transitional regime affecting coffee as the exchange rate applied to coffee would converge to the single rate in a time span of two years ending the so-called '*confisco cambial*' [foreign exchange

exaction]. Opposition in the ministry as well by presidential candidates led to Whitaker's fall even before the political collapse of the attempted coup by the 'liberals' in November 1955 and the successful 'democratic' countercoup which assured that the President elect, Juscelino Kubitschek, would take office in early 1956.

The difficulties faced by Gudin and Whitaker underline the kind of constraints faced by 'liberal economists' in the formulation and implementation of a truly liberal programme. Even Gudin, who rapidly exited from the Ministry of Finance due to its lack of 'political realism' found it difficult to condemn the inherited multiple exchange regime due to its fiscal implications. Whitaker's nominal commitment to liberalism was essentially marred by his political backing which made it impossible to consider policies which would unfavourably affect coffee interests.

The growth record in the 1945-1955 period was impressive, with GDP expanding at 7.1%. The record under Dutra was slightly better than in the first half of the 1950's with the economy growing at 7.6% yearly, in spite of the recession in 1947 when the yearly rate fell to 2.4%. In the two worse years under Vargas, 1951 and 1953, in spite of the difficulties concerning stabilisation, GDP increased at almost 5% yearly. However, population growth, which in the 1940's was at 2.4% a year compared to 1.5% in 1920-1940, increased to 3.0% in the 1950's. So the improved GDP growth record was rather less satisfactory on a per capita basis.

Industrial output (manufacturing industry after 1947) increased at 9.8% yearly in 1945-1955, more rapidly under Dutra because of the very significant growth in 1946 as part of the recovery immediately after the war. In contrast agricultural output growth was slow at 3.9% and more so under Dutra when it increased at the rate of 2.7% only. But the performance of subsistence agriculture in 1945-1950 was good with the output of rice and beef increasing at more than 8% yearly and corn and beans at more than 4%. But in spite of this, and in contrast with the 1930's, there was no significant contraction of the share of agriculture in GDP as agricultural relative prices rose in relation to industrial products. Employment in agriculture as a share of the active population fell from 65.9% in 1939 to 57.8% in 1949. The share of industry rose from 20.8% to 24.1% mostly at the expense of services. Industrial output structures in 1939 and 1949 were not radically different as the share of the textile sector in total value of production decreased only 2 percentage points

to reach 18.7%. But the relative contraction of most other sectors producing wage goods was substantial. Sectors producing industrial inputs, such as steel and iron products, as well as consumer durables and to a lesser extent capital goods, gained some ground. There is evidence, however, that structural change accelerated in the first half of the 1950s as import substitution spread to the production of most consumer durable goods. In 1949, the textile industry was still almost three times the size of the metallurgical industry. The textile sector combined with food processing answered for more than half the aggregate value of production compared to 56.8% in 1939 and 62.5% in 1919. The value of production of more modern sectors – electrical, mechanical and transport equipment – was 5.3% of the total in 1949 compared to 4.2% in 1939 and 1.3% in 1919. The productivity of labour engaged in manufacturing industry as of the census of 1949 fell to 4.7 times the productivity in agriculture compared to 5 times in 1939. The ratio of imports in total supply of industrial products, which reached a trough of 11.2% in 1942-1943, rose to a peak to 18-20% with the import boom in 1951-1952, and then started to fall rapidly: in 1955 it was already below 10%.

2. The golden years: 1956-1962

President Kubitschek had an initial choice between a stabilisation programme inspired by Edward Bernstein of the IMF and promoted by his more orthodox supporters such as Lucas Lopes and Roberto Campos. But it was politically expedient to stick to an overtly expansionary policy with J.M. Alkmin as a Finance Minister. However, the year of 1956 was for most purposes a transitional year as the government concentrated in drawing its plans. But the imbalances in public accounts increased significantly as the Treasury's cash deficit increased from 13.6% of expenditures in 1955 (around 1% of GDP) to 32.2% (around 2.6% of GDP) and GDP growth was only 2.9% as there was a significant crop failure. Inflation remained above 20% as measured by the cost of living in Rio.

The cornerstone of the President's economic programme was the *Programa de Metas* [Target Programme] which would allow the Brazilian economy to grow fifty years during the five years of his term of office [*50 anos em cinco*]. This was to cope both with the business of overhauling the infrastructure, left unfinished by Dutra and Vargas, and with the deepening of import substitution to cover the remaining consumer durables,

mainly motor cars, and industrial inputs. Also important, both as a drain in public resources, and as a project to mobilise political support, was the building of Brasília, with its implied national integration emphasis crowning a long of process of not very elaborated criticism of the concentration of expenditure and political power in the coastline in detriment of the hinterland.

Formulation of the Plan, heavily inspired in the previous work of the *CMBEU*, as well as on studies undertaken by the United Nations Economic Commission for Latin America, was the result of work by the *Conselho de Desenvolvimento* [Development Council], a new agency directly under the President. The Conselho orchestrated a large number of *grupos executivos* [executive groups] in charge of specific targets. There was no global macroeconomic framework coherent with physical targets mostly related to the infrastructure or to the industrial sector. There was also no attempt to define how the projects were going to be financed. Details started to be defined in the third year of the plan's implementation. Nor was there any special consideration of inter-industry implications of the planned increase in capacity. Major infrastructural targets referred to expansion between 1955 and 1960 of the road network (construction of 13,000 Km of roads and paving of 5,800 Km, compared to existing 460,000 Km and 3,100 Km, respectively) as also of railroads (construction of 3,100 Km, compared to the existing 37,000 Km). New industries producing rolling stock and ships were to be established. Energy targets covered increases in electricity generating capacity (from 3.2 MW to 5.2 MW), oil production (from 6,000 barrels to 100,000 barrels/day), oil refining (from 130,000 to 300,000 barrels/day) and coal production (from 2.1 to 3.1 million tons).

Government plans concerning the infrastructure were based on the recognition that the old model of energy utilities controlling power generation, transmission and distribution had been exhausted as exchange rate fluctuations had enormously increased the friction between such companies and the government and led to underinvestment. This explains the expansion of public involvement in the generation and transmission of electricity partly based on expertise accumulated by CEMIG, the rather efficient electricity company owned by the state of Minas Gerais. On the other hand, there was also the implicit recognition that the State would be unable to efficiently run the railway system so that at the planning stage, and even more during implementation of the *Programa de Metas*, it was apparent that the government had opted for the significant

expansion and improvement of the road network in detriment of a serious overhauling of the railway system. In fact, most of the government efforts concerning the railways was centred on the transformation of locomotives to oil burning in spite of the unfavourable effects on its plans to increase the production of high-ash high-sulphur domestic coal. There was also complementarity between plans related to the expansion of the road infrastructure and the target to produce domestically trucks and light commercial vehicles. The road versus rail competition which had become evident in the second half of the 1920's was going to be decisively won by the road in the second half of the 1950's.

Planned increased production of inputs included steel production (1.2 million to 2.3 million tons of steel), cement production (3.6 million to 5.0 million tons), chemical products, non-ferrous metals and cellulose. Iron ore output mainly for export was to be expanded. An automotive industry was to be established which would produce in 1960 170,000 vehicles with a crudely defined index of nationalisation by weight set at 95% for motor cars and 90% for trucks and vans. Industrial subsectors producing capital goods (heavy electrical equipment, machine tools, boilers and other heavy equipment) were singled out to be supported. Agriculture was covered rather incompletely by targets for tractors, fertilisers and wheat production. There was some nominal reference to education but again more as the lip service to make the plan politically more palatable.

State investment was to play a crucial role in the plan, especially in the targets related to infrastructure and the production of industrial inputs. There was a further expansion in the role of the State as a producer of goods with an increase in the number and importance of state enterprises. The share of government and government enterprises rose from around 25% of total investment before 1956 to a third in 1956-1960. The construction of two new integrated steel mills *Usinas Siderúrgicas de Minas Gerais-Usiminas* Minas Gerais Steel Mills and *Companhia Siderúrgica Paulista-Cosipa* [Paulista Steel Mills] was started. *Petrobrás* was in charge of the targets related to oil production and refining, given the legal state monopoly. It also increased its fleet of tankers. There was significant public investment in the construction of new state-owned hydroelectric plants in the Southeast. *Vale do Rio Doce* was to continue its expansion to become a major world producer of iron ore. *Companhia Nacional de Álcalis* would become an important producer of soda ash.

Interest of the private sector, and especially of direct foreign investment, was raised by the concession of comprehensive incentives which covered special fiscal treatment, credit subsidies -- mostly related to loans extended by BNDE --, and import duty exemptions. Since inflation remained most of the time above 12% and the usury law continued to be applied to obtain public credit was equivalent to obtain a stream of subsidies in the future. Private banks would not be involved in credit operations which were not short-term and were able to circumvent legal restraints by expedients such as fictitious administrative costs or by tying loan concession to the holding of deposits to compensate them for the negative real rates of interests implied by legislation in an environment marked by significant inflation. Implicit subsidies related to non-indexed Bank of Brazil loans are estimated to have varied in the 1956-1961 period between a low of 35% of the Treasury deficit in 1957 to a peak of 151% of the Treasury deficit in 1959. Bank of Brazil credit corresponded over the 1952-1961 period to between 48% and 53% of total credit with a slow declining trend after 1959. Credit by BNDE in the 1950's peaked in 1958 when it was equivalent to about 4% of total banking credit. BNDE played an additional crucial role which was to guarantee foreign loans contracted abroad by Brazilian enterprises totalling US\$ 890 million.

By far the most important instrument used by the government to attract foreign capital was Instrução 113 of SUMOC. After an initial period under the multiple exchange rate regime when the 'free' rate (applied to financial flows) was higher (cruzeiro/US dollar) than that applied to category 3 imports (capital goods) the position was reversed and the free rate remained in 1955-1957 below that of category 3 imports. There was thus a subsidy for capital entering the country in the form of equipment under Instrução 113 if compared to the alternative of entering as a financial flow and then competing for foreign exchange cover in the exchange auctions. After 1957 subsidy was to be assured by the free rate remaining below the 'general' import exchange rate. Exports reached a peak in 1951 and afterwards began a long process of decline. The peak of 1951 would only be exceeded in 1968. The use of other instruments to generate foreign exchange such as merchandise imports without foreign exchange cover under the terms of Instrução 113 was thus crucial to make possible high investment, and hopefully, high growth. About 75% of the foreign investment inflow into Brazil in 1956-1960 was under the regime of Instrução 113. Seen from the angle of imports no less than 70% of capital goods imports in the period were made under the same regime.

Another important factor of attraction of foreign investment was the Brazilian high tariff. The new tariff law 1957 had transformed the Brazilian schedule based on specific duties which had been almost completely eroded by inflation into a schedule based on *ad valorem* duties which could reach 150%. Government policy, by restricting right of establishment assured that a sufficiently low number of entrant foreign firms had sufficient market power to extract big profits behind the high import tariff wall. On the other hand, in the mid 1950's there was interest to expand productive capacity abroad, especially among European motor car manufacturers.

Under Kubitschek there was no attempt to modernise public administration machinery. This was a corollary of the 'fifty years in five' motto combined with a consensus that bureaucratic foot dragging should not be allowed to interfere with the *Programa de Metas*'s implementation. Typically, the existing machinery was circumvented mostly by the creation of transitional institutional arrangements. These took the form of *grupos executivos* [executive groups] created *ad hoc* to oversee the sectoral implementation of the *Programa de Metas*. But state enterprises also played an important role in the process of side stepping the traditional obstacles to "efficient" government. The conventional public administration machinery was left aside to continue in its long term declining trend portrayed by the mutually self-reinforcing combination of low levels of pay and low levels of efficiency.

The *Programa de Metas* certainly marked a deepening in the process of import substitution which became important in branches of industry unaffected until then such as the automotive industry and many segments of the production of industrial inputs, and to a lesser extent, of capital goods. But, given the scope for foreign direct investment, it is a tribute to Kubitschek's political acumen that he managed to see that his image of an economic nationalist prevailed in the Brazilian political folklore. A reasonable explanation for his achievement is perhaps the emphasis placed in the Brasília project as a symbol of a new sense of nationhood more representative of the Brazilian hinterland realities away from the relatively cosmopolitan coastal regions. His image as a nationalist was also enhanced by the fact that in the public mind the President when faced with a choice repeatedly opted for 'development' instead of 'stabilisation'. The yearly net inflow

of direct foreign investment including reinvestment rose from less than US\$ 60 million yearly on average in 1947-1954 to almost US\$ 140 million in 1955-1961.

While it is generally accepted that stabilisation objectives had a very low priority under Kubitschek the favourable evaluation of other aspects of his administration especially in the political field tends to obscure how bad was the macroeconomic management between 1956 and 1961 and the extent to which, aggravated by Quadros' political irresponsibility in 1961 it contributed to the economic turmoil which was an essential element to explain the military coup of 1964. If the traditional Brazilian paradigm of the '*homem cordial*', who in all circumstances feels it difficult to say no, which is ruled by the heart, can be transposed to policy-making, Kubitschek, with his utter disregard for macroeconomic constraints, fitted it extremely well. It would certainly be an exaggeration to consider his behaviour as strategic, though his lack of enthusiasm for electing a successor of his own party was well known. Kubitschek was simply applying at the Federal level the populist recipe which had been extremely successful in his mayorship of Belo Horizonte and when he was governor of Minas Gerais. From a macroeconomic point of view Kubitschek's vengeance was that he left to Quadros an inheritance even worse than the one that he had received in 1956.

Inflation in 1956 measured by consumer prices was at about the same level of 1954-1955. In 1957 it declined to 15% and on average remained at the same level in 1958. But yearly data hide important monthly fluctuations. In 1956 monthly inflation rates were maintained below 2% and in 1957 after some instability consumer prices fell in some months almost 2% due to the very good crop. But in early 1958 inflation accelerated once again to reach 2.6% in May. Inflationary pressures originated in the continued imbalance of public accounts as the government deficit mounted to 26% of total expenditure in 1956 and 40% in 1957, boosted by the building of Brasília, the new capital, by the chronic deficit of government-owned transportation concerns and by purchases of surplus coffee output. These latter amounted in the second half of the 1950's to three times the direct cost -- estimated at 2-3% of GDP -- of building Brasília. Coffee purchases absorbed more resources than those generated by the wedge between the average exchange rates for the sale and the purchase of foreign exchange which was a feature of the multiple exchange rate regimes in force during the period. Transfers to government-owned transportation concerns fluctuated between 10% and 25% of the

aggregate deficit in 1956-1960. On the revenue side from the mid-1950's growth of consumption and stamp tax revenues started to outpace income tax growth. The 1957 reform also meant that import duties became relevant again. By 1961 Federal revenue was made up of taxes on consumption (38.8%), income (26.5%), import and stamp duties (both 11.3%). Both the consumption tax and the tax on sales, which had displaced export taxes as the main source of revenue for the states, were value added taxes but taxes on the value of transactions with all the resulting distortions due to cascading. The tax burden increased from 15% in 1947-1950 to 16.3% in 1950-1955 and 19% in 1956-1960. Inflation total transfers (including inflation tax effects on the public and the banks) rose to around 4% of GDP in the mid-1950's.

The deterioration of macroeconomic conditions led to still another stabilisation attempt. Lucas Lopes and Roberto Campos with a delay of two and half years seemed to have their chance to implement a stabilisation programme: a one-year *Programa de Estabilização Monetária* [Programme of Monetary Stabilisation] was to be implemented as a first step in the road to stabilisation. But Kubitschek resisted to abandon his cherished expenditure plans and his half-hearted launching of the stabilisation programme was an indication that it was doomed to fail. The plan's core was familiar: credit control and expenditures cuts, especially of transfers to public-owned railways and shipping companies. There was some progress in relation to the public deficit which was halved in 1958 to 20% of total expenditure. But banking system loans to the private sector, including the Bank of Brazil, fell only modestly due to the pressure of coffee growers squeezed by the coffee crisis. In spite of much criticism of the Bank of Brazil as responsible for undermining of the programme its loans fell almost 16% in 1959 in real terms. The second half of the 1950's were marked by the continued fall of real credit per unit of GDP which decreased a further 23% between 1956 and 1960.

Under Lopes the monthly inflation rate measured by the wholesale price index remained above 2% until May 1959 and was above 5% in some of the months of the Summer of 1959. Ironically, in July, when the inflation rate reached its lowest rate since the beginning of 1958, Lopes was substituted by Paes de Almeida, the former president of the Bank of Brazil. The emphasis on development prevailed. Public deficits increased again, reaching 25-26% of total expenditure in 1959-1960. The yearly inflation rate for 1959 of nearly 40% was probably a record since the early 1890's.

Protracted negotiations with the International Monetary Fund came to nothing as the Lopes-Campos group lost influence. The Fund was apparently prepared to accept the Brazilian proposals on monetary and fiscal policies but deemed unsatisfactory changes in tariff and exchange rate policies. It was announced that Brazil had broken off relations with the Fund. Brazil, of course, remained a member of the Fund and rather than a 'ruptura com o Fundo'[break with the Fund] there was something rather less spectacular: a break down of negotiations with the Fund. The myth of the 'ruptura com o Fundo' and its astute political exploitation by Kubitschek enhanced his reputation as a nationalist who had the courage to defy the IMF and served as an at least partial explanation of the bad macroeconomic performance in 1956-1961 as resulting from foreign constraints. It was stressed, but not very convincingly, that there had been a serious intention to stabilise, but the political price asked by the IMF was too high. Probably the price asked was too high, but was there a serious intention to stabilise?

Structural theories of inflation were popular in Latin America in the 1950's and early 1960's. Alternative versions included from the more trivial structural imbalance version, generally with agriculture in the role of the laggard sector, which related higher inflation to growth above a balanced growth rate, to more complex interpretations which related inflation acceleration to sectoral terms of trade. Brazilian versions of such interpretations included a stress in the market power of intermediaries in the commercialisation of foodstuffs for which there is some, but not overwhelming, empirical basis in the late 1950's and early 1960's.

The exchange regime created by Instrução 70 in 1953 was simplified in 1957. The introduction of an *ad valorem* tariff schedule made it possible to reduce the number of multiple import exchange rates which had been created mainly as a substitute for such a tariff. The former five import categories were reduced to two: a general category to include raw materials, capital goods and products for which there was not 'sufficient supply'. Imports of other goods were to be paid using the 'special' category exchange rate which of course made them more expensive. A third category of imports, oil, newsprint, fertilisers and 'equipment for priority projects' were to be paid at the 'câmbio de custo'[cost of exchange rate] which could not be below the weighted average export rate. Auctions for the two import categories as well as the four export bounty categories were

maintained but in later years non-traditional exports were increasingly paid at the free 'rate'. A newly created *Conselho de Política Aduaneira* [Customs Policy Council] with wide discretionary powers to classify imports in different categories as well as to partially waive duties or block imports using the 'similarity criterion' which blocked imports of products which could be produced domestically. One third of Brazilian imports still originated in the United States but some European suppliers, especially Germany, had been gaining ground in the 1950's.

Exports fell steadily during Kubitschek's government. In 1958-1960 they reached US\$ 1.2-1.3 billion compared to more than US\$ 1.7 billion in 1951. In spite of the advance of industrialisation Brazil remained very much an exporter of commodities and mainly of coffee. Coffee exports which in the early 1950's were 60-70% of total exports maintained their importance in the middle of the decade and fell only slightly below 60% in 1960. The US market still absorbed around 45% of total exports and Europe under 30%. Coffee prices by the end of 1955 were back to their levels of the beginning of 1953. In 1957 they started to decline again as the well-known long-term coffee price cycle unfolded. In 1959-1961 coffee export prices were roughly two thirds of 1955-1957 prices due to a collapse in the second half of 1958. Coffee scarcity in the early 1950's stimulated substantial expansion of supply both in Brazil and elsewhere so that in the second half of the 1950's Brazil was once again facing problems of coffee overproduction.

Over Kubitschek's term of office the foreign debt increased by 64% to reach US\$ 2,372 million by the end of 1960 so that the gross debt-export ratio deteriorated from 1.02 by the end of 1955 to 1.87 by the end of 1960, as exports were roughly stagnant. In the window of opportunity created by the hope of sustained adoption of a stabilisation programme there was an interruption of the World Bank abstinence from lending to Brazil as US\$ 98 million of loans were provided to the electricity sector in Brazil. In the later years of the Kubitschek period the government repeatedly resorted to high cost US dollar-cruzeiro swap operations guaranteed by the gold reserves through which the government raised foreign exchange cover in the short term and accepted the devaluation risk.

Levels of social indicators were still very low in 1960: average infant mortality was 118.1 per thousand 1,000 live births (198.2 in Rio Grande do Norte and 68.6 in Rio Grande do Sul) and the aggregate literacy was 60.6% (57.3% among women). But they had improved substantially more in the 1950's than in the 1940's: at a rate 2.2 times higher for infant mortality and 2.5 times higher in the case of literacy. But improvement was much slower in the poorer than in the richer regions: reduction in infant mortality in the South region in the 1950's was 2.1 faster – in terms of percentage of the gap (in relation to targets) reduced in the decade – than in the Northeast.

The ratio between productivity of labour in manufacturing industry increased substantially in relation to productivity in agriculture to reach 7.5 times as recorded by the 1949 census. Industrial employment increased 3% yearly in the 1950's while the industrial output increased 9.2%. In fact industrial employment increased marginally less in the 1950's than in the 1940's. Only a small part of the very substantial increase in industrial productivity is estimated to have had origin in changes in the structure of occupation. Agricultural employment increased 1.8% yearly and agricultural labour productivity increased by 30% in the decade. In the 1950's the share of agricultural employment in total active population fell only modestly from 57.8% to 54%. The acceleration of the rate of population growth meant that there were going to be in the future increasing strains to absorb the cohorts of labourers seeking employment and the services sector would tend to absorb such manpower surpluses. In contrast with the second half of the 1940's, minimum wage policy in the 1950's was relevant, as there was some attempt to keep constant its real value which reached a peak in 1959. In a rather innocuous effort to contain some of the undesirable consequences of higher inflation the Federal government tried to control basic food prices in the 1950's and early 1960's through the *Comissão Federal de Abastecimento e Preços-COFAP* (Federal Commission of Supply and Prices). Different modalities of rent control were also adopted in the 1950's.

In the late 1950's there were efforts for the first time by the Federal government to consider in a more systematic way policies related to the removal concerning the inequalities between different Brazilian regions. The recognition of such inequalities stretched long before 1930. The drought in the late 1870's had an important role in expelling population from the Northeast to other regions such as the Amazon. An

important public works programme had been undertaken under Eptácio Pessoa in the early 1920's to build up reservoirs in the Northeast. Both the São Francisco and the Amazon valleys had public agencies nominally in charge of promoting their development since the 1940's. An obsolete and ineffective *Departamento Nacional de Obras contra as Secas* [National Anti-Drought Department] had failed to make substantial progress in alleviating the effects of periodical droughts in the Northeast. Under President Kubitschek efforts were concentrated on the study of regional inequalities and formulation of policies to revert such trends. A *Grupo de Trabalho para o Desenvolvimento do Nordeste (GTDN)* [Working Group for the Development of the Northeast] was created. Its conclusions suggested two lines to cope with the economic problems in the Northeast. The first, which was to remain a dead letter, was to adopt policies which would foster the transformation of land use both in the humid and semi-arid zones, and the dislocation of the region's agricultural frontier. The second was to raise the productivity of labour employed in the humid region by creating industrial jobs. Following these recommendations a *Superintendência de Desenvolvimento do Nordeste (Sudene)* [Superintendency of Development of the Northeast] was created in 1959 and massive fiscal incentives were directed to finance the migration of investments to the region but this occurred mostly after 1964.

It has become customary to claim that the *Programa de Metas* was successfully implemented in 1957-1961. But success has to be qualified even if account is not taken of its heavy macroeconomic cost. It is certainly relevant to stress that the Brazilian economy went through a period of very rapid growth and that this was explained to a large extent by the investments planned under the plan. But the comparison of sectoral targets and achievements point out to a clear division between targets which were seriously pursued and those which were not. There was an unqualified failure in meeting targets concerning wheat, coal, railway construction and oil refining. The most successful effort was in relation to road building whose target was exceeded by 38% and electric power generation projects which met 82% of their target. The fulfilment of many targets concerning the production of steel, cement, oil and cars and trucks remained between 60 and 76% of initial plans.

But these shortcomings are put in perspective by the outstanding growth record of the period. GDP increased on average by 8.1% yearly between 1955 and 1960. 1956 was

quite a bad year as GDP increased only 2.9%, the worst performance on record since 1947. If the plan period of 1957-1961 is taken into account GDP growth was of 9.3% yearly. The Programa de Metas raised gross fixed capital formation as a proportion of GDP from around 14.5-15% in 1956-1957 to peak levels of 17% in 1958 and 18% and 1959. The extremely high rates of GDP growth suggest that increased capacity utilisation probably played a relevant role as a source of growth in the late 1950's. Between 1956 and 1961 industrial output increased at 11.4% yearly. This was of course concentrated in the branches of industry directly or indirectly most affected by the *Programa de Metas*: transport equipment (42% yearly rate of output growth), electrical and communications equipment (24.1%) and rubber products (16.4%). But even traditional sectors such as textiles had a good performance with output expanding at more than 10% yearly. Estimates of the relative importance of sources of industrial growth indicate that about a third of industrial growth between 1949 and 1962 was related to a fall in the import coefficient rather than demand or export growth. This very good industrial performance tends to hide the fact that agricultural performance was very creditable with output increasing at 5.8% yearly. Food production for domestic consumption (beef, milk, manioc, corn, beans and rice) more than kept pace with population growth.

3. Crisis in the early 1960s

It is essential to put into perspective the achievements of Kubitschek to consider the long-term effects of policies adopted during his term of office. His successor, Jânio Quadros rightly stressed how unfavourable was the inherited macro-economic position: high inflation, fiscal imbalance and prospective balance of payments crisis with eroded reserves. His main objective became inflationary control and this was to be achieved through policies which removed constraints related to the public deficit and the balance of payments. Steps were taken to unify the exchange rate: the former 'general category' imports were transferred to the so-called free market. The 'câmbio de custo', which applied to imports deemed essential such as wheat, fuels and newsprint, was devalued 100% (cruzeiro/US\$ dollar rate) and transferred to the free market. But auctions for the 'special category', that is non-essential imports, continued to take place. A new system of sale of foreign exchange to cover imports was introduced. This was based on the compulsory purchase of import bills made at the same time exchange cover was bought by importers of the same amount in cruzeiros of bills which would mature in 150 days.

Already in the end of the Kubitschek period some exporters were paid in Bank of Brazil paper rather than in cash but this was discontinued by the end of 1961. In certain periods between 1962 and 1964 the importer could decide between purchasing Bank of Brazil paper earning 6% yearly for four months or make non-interest deposits for larger amounts. Part of coffee export proceeds continued to be retained and other exporters could sell export proceeds in the free market.

The reform meant the end of possibility of using the 'ágios e bonificações' account to generate resources in domestic currency. Suggestions that this is at the root of disequilibrium of government accounts and consequently of inflation seem to be displaced. The net result of such accounts had not been always substantial in the past and the fall in their importance had been counterbalanced by other ways to raise revenue such as sales of import bills or compulsory import deposits. Balance of payments equilibrium required the re-schedule of foreign debt service payments which were heavily concentrated in the short-term: more than 60% in the four years following 1960. Foreign debt service increased very fast since 1955, rising from 13% of exports to 43.6% in 1960. The service of loans totalling US\$ 1.1 billion, of which 80% in the United States, was rescheduled in 1961. This was Quadros' main achievement.

The political crisis which followed Quadros' sudden resignation in August 1961 increased uncertainty about future developments which could unfavourably affect the economy. It was feared that Goulart, the Vice-President who according to constitution was to succeed Quadros, would only add to the trend towards increasing lack of control which had become marked since the demise of the 'Programa de Estabilização Monetária' of 1958-1959. Since his experience as Vargas' Labour Minister in 1954 Goulart had been elected Vice-President both in 1955 and 1960 with strong support of the trade unions. These fears were not totally allayed by the compromise which introduced a parliamentary regime and curtailed presidential powers.

The composition of the first cabinet revealed an attempt by Goulart to enter into a composition with the conservatives. The choice of Neves as Prime Minister and, especially, Moreira Salles, a politically influential banker in the centre of the political spectrum, as Finance Minister, suggest a continuity of the endeavour to regain control over the economy. Neves' program was, however, mainly rhetorical and full of

inconsistencies. The government was going to seek to revert the massive monetary expansion which had resulted from the political crisis in mid-1961 and to maintain monetary supply stable. Public deficit was to be financed on an undefined 'non-inflationary' basis. Lip-service was paid to many reforms, including a fiscal reform which was to generate resources which would make possible to increase fixed gross capital formation from 14% to 23.75% of GDP in five years. A realist foreign exchange policy was to be adopted based on a single exchange rate but quantitative import limits in the 'special category' were to be maintained. Goulart, in spite of opposition by his cabinet, entered into a personal commitment to reform the constitutional principle that acquisition of land for land reform purposes should be on a cash basis only.

The economic record in 1961 was not that unfavourable: inflation remained roughly stable at around 30% a year (cost of living Rio de Janeiro) and GDP increased 8.6% with industrial output growing 11% and agriculture 7.6%. But there was a sharp fall in gross capital formation to 13.1% of GDP, the lowest level since 1950. the foreign debt increased by US\$ 0.5 billion to US \$ 2,835 million at the end of the year in the wake of the negotiations on rescheduled payments. This corresponded to a gross debt-export ratio of 2.0. Reserves increased by US\$ 307 million as exports recovered by about 10% but still remained much below their 1951 peak.

Coffee exports in the Goulart years still answered for 50-53% of total exports. The United States still absorbed 40% of Brazilian exports but was being rapidly substituted by Europe. In early 1960 the Treaty of Montevideo had been signed establishing the Latin American Free Trade Association which included most South American economies and Mexico. The total elimination of trade barriers was to be achieved in twelve years by means of yearly negotiations which would reduce by at least 8% the the weighted average duties applicable to third countries in favour of LAFTA members. After a promising start in 1962 and 1963 negotiations the process came to a halt.

Import-related remittances had been discouraged by thinly disguised devaluation such as the increase to 150% of the import value of the compulsory purchase of import bills which had to be held for 150 days without earning interest with the inflation around 30% a year. Financial operations required purchases equivalent to 50% of the remittance

to be held for 180 days. In early 1962 these measures were temporarily reversed as the percentage of required purchases was to be progressively reduced by 10 points monthly.

The marked deterioration of relations with the United States had political reasons since the shifts implied by Quadros new policies and , especially, after Brazil had abstained from the vote to expel Cuba from the Organization of American States. Brazil-United States relations were further strained by impending legislation, reminiscent of Vargas' much criticised speech in the end of 1951, that would set a 10% limit on yearly remittances by foreign firms and that reinvestment could not serve as a basis for computation of profits which could be remitted. And also by the cancellation of mining rights of the Hanna Corporation and the condonation by the Federal government of Governor Brizola's expropriation of *Companhia Telefônica Nacional* [National Telephone Company], a subsidiary of the International Telephone and Telegraph which operated in Rio Grande do Sul. This expropriation followed a previous wave of expropriations in 1959, also by Brizola, of the *Companhia de Energia Elétrica Rio-Grandense* [Electrical Energy Company of Rio Grande], a subsidiary of the American Foreign Power Company, and of other ITT assets. The yearly net inflow of new direct investment was sharply reduced to less than a third of its level in the second half of the 1950's but reinvestments were significantly higher as investments matured.

It is not surprising that foreign debt growth slowed down after the renegotiations of 1961: it increased less than 9% until the end of 1963. This reflected the increasing difficulties of raising foreign loans as the government's became progressively more nationalist and hostile to foreign investment. The United States official loans which were extended under the Alliance for Progress programme were mainly directed to states where governors were political opponents of the President. Inter-American Development Bank's loans totalling US\$ 133 million in 1961-1963 provided some relief. The debt-ratio of 2.47 was high but still very distant from the 4.0-5.0 range typical of the great depression or of the early 1980s.

Goulart's visit to the United States in April 1962 to reassure the US government on foreign investment and the foreign debt was not a success. It was clear that there was a progressive deepening of the fiscal crisis. The public deficit increased from 26.1% of total expenditure in 1960 to 29% in 1961 and then to 33-34% in 1962-1963. The tax

burden fell to 18.2% in 1961-1963 and seigniorage increased from 4% to 7-9% of GDP. Most of the pressure on the level of expenditures was related to the massive deficits of public-owned enterprises such as the railways and shipping companies: *Rede Ferroviária Federal* [Federal Railways Network], *Lloyd Brasileiro* [Brazilian Lloyd] and *Cia. de Navegação Costeira* [Coastline Navigation Company]. In May 1962 the lack of fiscal and monetary control became evident and added to political difficulties centring on structural reforms and foreign policy. Neves, very much a man of the centre, resigned and an aborted further attempt to counter deterioration in the control of macro-economic policy was made when the name of Santiago Dantas was considered for Prime Minister. In spite of being more often associated with the more radical leanings of Goulart's administration because of his support of a foreign policy more independent in relation to the United States, he was firmly committed to a policy of ordering government priorities, expenditure cuts and monetary restraint. His inability to win congressional approval as Prime Minister underlined the costs of the political stalemate.

After a further attempt to obtain congressional support for special powers for his chosen Prime Minister, Brochado da Rocha, Goulart invested all his political resources in recovering presidential bargaining power with the repeal of the parliamentary regime. But after this attempt the political basis of the coalition in government was eroded as shown by the substitution of Moreira Salles by Dantas. Strengthening of the parties supporting Goulart in the elections in October 1962 was followed by a massive victory of a return to a presidential regime in early 1963 amid further acceleration of inflation to reach 5-7% a month and continued slowing down of growth. In 1962 financial system real credit stagnated. The yearly inflation rate in 1962 rose to a level near 50% whatever way it is measured. Additional inflationary pressures were related by the approval in the end of 1962 of new legislation on the '13th' wage, an additional monthly wage to be paid to all workers at the end of the year.

GDP growth fell to 6.6%, the lowest rate since 1956. But manufacturing industry output which had played a central role in the growth process since 1942, and especially under Kubitschek, still increased 8.1%. Agricultural output increased by 5.5% even if coffee production fell in physical terms. The good agricultural record since the mid-1950's tended to undermine the core of the case for land reform as the growth of food production was not being outpaced by population growth. Data on fixed capital formation

point out to a recovery to 15.5% of GDP in 1962 which is not unlikely to have resulted from defective national accounts statistics as most sectoral data point out to a sharp fall in investment after 1961.

The fall in exports and in capital inflows together with the modest rise in imports, maintained pressure on the balance of payments. But there is no evidence of severe distortions in the foreign exchange regime. There was a reduction in the compulsory purchases of import bills and the cruzeiro devaluation was similar to the rate of domestic inflation. It would be wrong to put too much emphasis on the foreign exchange policy to explain the balance of payments difficulties: the effective exchange rate in 1962 was at practically the same level of that of 1964 and, according to the World Bank, very near its peak (most devalued) level between the early 1960's and the late 1970's. It was in 1963 that it became overvalued but not much beyond the level typical of the second half of the 1960's.

Following the government's victory in reversing the parliamentary constitutional amendment of 1961 in a referendum in early 1963 a last ditch attempt was made to revert the acceleration of inflation. Celso Furtado, who had added to his reputation as an author on the Brazilian economy the work developed at the GTDN and at Sudene, supervised the elaboration of a *Plano Trienal* [Triennial Plan] was to serve as a guideline for policy placing strong emphasis, in spite of the heterodox views held by Furtado in the past, on the control of inflation and singled out excessive demand entailed by the excessive level of public expenditure. The aim of the stabilisation programme was to reduce inflation to 25% in 1963 and 10% in 1965. Potential public deficit was to be reduced by 60%. Nominal limits of credit expansion for the private sector were set at 35% when the equivalent yearly inflation rate was 60%. An International Monetary Fund mission visited Brazil early in the year.

The plan allowed for 'corrective' inflation as there was need to adjust some administered prices, following subsidy cuts mainly affecting fuel and wheat. In January urban transportation prices were increased. Prices of fuel and wheat were increased by 100% and 70 %, respectively. Monthly inflation rates in the first two months of 1963 reached 20% and 11%. This may have been partly the result of price adjustment of those fearing a price freeze.

There is evidence of considerable overshooting in the implementation of credit limits: the real volume of credit fell 30% in the first semester of 1963. This certainly helped to fuel the choir of criticisms initially raised by many of Goulart's allies in the extreme left. The *Plano Trienal* was criticised as a capitulation of the government to conditions established by the International Monetary Fund. To the political troubles aggravated by overshooting must be added the consequences of Dantas' failure in his visit to Washington to negotiate another reschedule of the foreign debt. In spite of Brazilian concessions concerning the expropriation of the AMFORP utilities, only US\$ 84 million of the US\$ 398 million of loans obtained by Dantas was to be immediately available and even then US\$ 30 million were to compensate ITT. Political decisions in May irreversibly undermined the stabilisation objectives as the civil service pay rise was set at 60%, and not the 40% agreed with the IMF. The minimum wage was increased by 56.25%. Wheat and fuel subsidies were reintroduced.

From mid-1963 economic policy was beyond the control of Federal authorities. A ministerial reform substituted Dantas and scrapped the Planning Ministry. Goulart tried to appease widespread criticism of his government among the 'classes produtoras' by choosing a conservative Paulista, Carvalho Pinto, as the new Finance minister. But the reaction of the more radical wing of his political supporters was strident as it had been in their denunciation of the *Plano Trienal*. Administrative instability resulted from the fragmentation of political resources originating in the frontal clash between populism and its opponents, and a broad conservative coalition rapidly gained adherents. Campos' decision to ask for substitution as the Brazilian Ambassador in Washington heralded the end of the period of guarded co-operation between Goulart and conservative leaders which could assure him of some support outside his power basis in the trade unions and the left wing parties. The lack of control on public expenditure deepened after the middle of the year. Monthly inflation rates rapidly returned and exceeded the levels reached before the *Plano Trienal*. The balance of payments position deteriorated further in spite of some recovery of exports as coffee prices increased 60% . Required purchases of import bills were substantially increased, especially in the second semester of 1963, reflecting growing uncertainty. On a year to year basis the real exchange rate appreciated almost 14% in 1963.

Goulart's obvious lack of a credible economic programme is best exemplified by his appointment of an obscure *gaucho* politician as a substitute of Carvalho Pinto in the end of 1963. Goulart also finally approved the law on remittances of profits by foreign firms. The demand for structural reforms, on the other hand, gained political weight although there was an almost total absence of explicit economic evaluation of their costs and benefits. Attention was centred on the proposed take over of private oil refineries whose establishment preceded the creation of Petrobrás, which can hardly be considered a structural reform, and, quite generically, on land reform. Political troubles with the military and agitation around the structural reforms fed the conspiracy against the government which had initially been restricted to certain groups defeated in their intent to deliver a coup in the crisis of 1961 and had gained strength after the 1962 elections. The military coup which followed on the 1st of April had considerable political support from most political parties as well as from landowners, industrialists, and the middle class.

In the whole 1942-1962 period GDP per capita only decreased in 1956, and even so very marginally. In 1963 GDP growth was only 0.6% as a fall of 0.2% in industrial output coincided with agricultural output growth of only 1%. Recession hit hardest exactly in those sectors which had led the previous boom. Output fell by 10.7% in transport equipment and 3.8% in electrical equipment industries. It fell modestly even in the wage goods sectors. There was a fall in the rate of growth of food production in the early 1960's in comparison with the second half of the 1950's. But it still remained above population growth in the case of most products with the exception of beef and corn.

In per capita terms GDP contracted 2.3% in 1963. It is difficult to overstate the political significance of such a break of an extremely good continuous growth record. The reasons which explain such a decline in growth were the subject of intense controversy. The whole picture is confused by the fact that national accounts data indicate a hefty rise in investment even in 1963. According to such data, fixed capital formation in 1963, at 17% of GDP, had been only exceeded since 1947 in golden year of 1959. Data on sectoral data fail to pick up this reversal in the new trend lower investment ratios first shown in 1961. Possible explanations could include the inability of the Federal government to impose rational cuts in its investment programs so that fixed proportional cuts affected similarly all projects whatever their initial marginal efficiency of capital. Large investments did not necessarily mean a similarly large expansion of productive

capacity given the postponement entailed by cuts in available resources. An alternative less convincing reason, at least for this period, is that import substitution deepening tended to increase the cost of inputs and capital goods so that investment became relatively more expensive.

Explanations of a structural nature underline the importance of the exhaustion of import substitution as a process able to assure high growth of manufacturing industrial output. Given that the initial size of plants installed in answer to incentives under Kubitschek exceeded the capacity of Brazilian markets to absorb their output it was to be expected that the first wave of investments could not be sustained. The deepening of import-substitution moreover meant that as new sectors were affected the relevant marginal capital-output ratio increased and contributed to reduce growth potential. Another line of structural reasoning stressed the lack of compatibility between the newly structure of supply and effective demand related to the heavily concentrated income distribution. This latter explanation was disposed of by the very high rates of growth achieved during the boom period after 1967 based on a dramatic expansion of credit for consumer durable purchases.

Alternative explanations stress the impact of the extremely contractionary short-term macroeconomic policy adopted in the first few months of 1963 on the level of industrial output as well of investment. There is no doubt that liquidity tightening in early 1963 strongly affected the performance of sectors producing durable consumer goods. But the link between the squeeze under the *Plano Trienal* and the fall in investment, which is any case rather difficult to measure, given the misleading information supplied by national accounts data, fails to take into account the expected lags between fall in output and fall in investment. Based on the available evidence it seems reasonable to explain the fall in the level of activity as resulting from the combination of both structural and short-term or mid-term policies.

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The economic record in the Third Republic was dominated by the achievement of fast and sustained growth of GDP. Industry substantially increased its importance in output by displacing agriculture, especially in the 1950's. The extreme disparities

between productivity in industry and the other sectors of the economy increased, as the expansion of industrial output was not matched by the creation of a sufficiently large number of industrial jobs. But the performance of the food-producing agricultural sector was far from mediocre in the 1950's and even the early 1960's. There were also important changes in the structure of industrial output itself as there was much more rapid expansion of sectors producing durable consumer goods and industrial inputs, and to a lesser extent, capital goods than of those wage good sectors which had led industrial output growth in the 1930's and in the 1940's. There is more continuity between Dutra, Vargas to a lesser extent, Café Filho, and Kubitschek periods than usually admitted. Growth was faster and import substitution affected increasingly more sophisticated branches of industry but the trend was there.

Modernisation of the productive structure notwithstanding Brazil remained an exporter of commodities and mostly of coffee. Export diversification had no place in the government's agenda. In fact one of the most impressive features of economic policy in the second half of the 1950's is the continued importance of expenditures to support coffee prices. The coffee wedge between average import and export exchange rates may have existed to extract income from coffee growers but a sizeable part of this was returned through transfers to the coffee sector, either purchasing surplus stocks or providing a stimulus to the destruction of older, less productive, coffee trees.

What made possible to achieve and sustain this path of high growth was the combination of an initially stabilisation-induced overvaluation of the exchange with import control, assuring absolute protection essential to foster import substitution, followed by the expedient of using the multiple exchange regime to provide powerful subsidies to attract foreign capital to the Brazilian market. The government also used generously other subsidies such as subsidised credit and fiscal rebates of various kinds to implement its industrial policy. An additional crucial feature of the policy was that the Brazilian market would remain for all purposes closed so that the output of foreign firms would not face competition from imports. There was a vicious circle in action. The balance of payments constraints stimulated the adoption of policies based on the heavy subsidisation of domestic production which depended crucially on closing up the market. Domestic production was not competitive in international markets so exports tended to depend exclusively on commodities. Evaluation of such policies crucially depend on the

time span which is used as reference. If evaluation is restricted to period when import-substitution took place the assessment tends to be favourable as the growth record tends to dominate the picture.

But in a long term perspective such industrialisation spurts had a cost which was that generally they were not accompanied by sound macroeconomic policy. While this was already evident in the later period of the Dutra administration, and even more of the Vargas administration, it became particularly clear under Kubitschek and reached a climax under Goulart. Growth was faster until 1961 but partly because of a sharp deterioration in the accepted standards of sustainable macroeconomic policy. Political calculation became an extremely short-sighted exercise when applied to the economic field. The concept that the economic inheritance which was left to the successor should be at least reasonable carried no weight. The repeated failure of stabilisation efforts, generally implemented in the first half of terms of office, resulted more from the persistent fiscal imbalances and the lack of agreement to put their redressing high in the political priority list than on structural sources such as stagnant food supply or sectoral market power.

Rent-seeking which had been concentrated in coffee and tariff policies during the Old Republic had been diversified in the 1930's to cover opportunities opened by the operation of multiple exchange rate regimes. In the last years of World War II relatively high inflation combined with the usury law enhanced the importance of public credit, particularly long-term credit, as a powerful instrument to extract resources from the State. All these rent-extraction mechanisms were preserved from the late 1940's to the early 1960's with the multiple exchange rate regimes offering new implicit subsidy opportunities as exemplified by the advantages favouring foreign direct investment through SUMOC's *Instrução 113*. During part of the period the role played by the high tariff in providing an umbrella for domestic producers to generate high profits, or to be very inefficient, or both, was played entirely by the exchange rate system as the specific tariff was eroded by inflation until the schedule became based on *ad valorem* duties in 1957. The discretionary power in the distribution of incentives tended to be exerted in a less centralised way that had been the case in the past as there was strong private sector representation in the sectorally organised *grupos executivos*.

By the second half peak of the 1950's distortions were affecting resource allocation in extremely complex forms. It is to be doubted whether the government had a very precise idea of the joint impact of so many instruments used at the same time. The foreign exchange wedge between average import and export exchange rates was at work. Special provisions favoured foreign investment. A high tariff still prevailed with the government strengthening its *de jure* and *de facto* grasp on the right of establishment of foreign firms in the Brazilian market. Not only in some cases such as banking and insurance the government could and would block the entry of new players, by denying subsidies to more than a certain number of previously selected the firms, the government could make unprofitable the entry of new competitors into the market. The activities of many public-owned suppliers of public services depended on massive subsidisation. The coffee sector was also being subsidised directly and indirectly to counter the effects of the collapse of coffee prices. The fiscal burden became impossible to bear: there were too many sectors demanding and obtaining resources from the State. The inability to choose between conflictive targets was to become increasingly a feature which determined economic policy under the Third Republic. In last couple of years this shortcoming entirely dominated the economic and political scene.

The campaign for structural reforms singled out land reform as requiring the special attention of the government. But this was perhaps a too limited view of the limitations of growth policies adopted until then. Very rapid growth had only been accompanied by rather slow improvement in the living conditions of the poor everywhere. The position of social indicators improved in the government's list of priorities does not seem to have improved, but, of course, faster growth meant relatively more rapid improvement of such indicators in the 1950's than had been the case in the past. Even with high growth employment opportunities increased much too slowly. Increased population growth together with employment trends in the 1950's indicated the problems ahead when growth slackened.

While the government became somewhat belatedly aware of the problems entailed by the uneven regional distribution of the benefits of growth this trend resulted partly from its own investment strategy. It is difficult to exaggerate the importance of decisions during Kubitschek's term of office to define the characteristics of the future economic structure of the Brazilian economy and consequently the type of problems it

would face in the future. In a planning effort that was not known for internal consistency there was a clear concentration of inducements for the creation of an important automotive sector and in complementary investments in enhancing of road infrastructure and oil refining capacity. Expansion of the output of transport equipment was initially presented as essentially an effort to substitute imports of trucks and commercial and commercial vehicles but the seeds of an economy whose performance would depend on the diffusion of consumer durables, and especially of motor cars, were clearly there.